ANNUAL REPORT
OF THE
PENSION MANAGEMENT OVERSIGHT COMMISSION

Indiana Legislative Services Agency
200 W. Washington Street, Suite 301
Indianapolis, Indiana 46204

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INDIANA LEGISLATIVE COUNCIL
2007

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A copy of this report is available on the Internet. Reports, minutes, and notices are organized by committee. This report and other documents for this Committee can be accessed from the General Assembly Homepage at http://www.in.gov/legislative/.

I. STATUTORY AND LEGISLATIVE COUNCIL DIRECTIVES

The Indiana General Assembly enacted legislation (IC 2-5-12) directing the Pension Management Oversight Commission (Commission) to do the following:

(1) Study the investment and management practices of the boards of the public retirement funds.
(2) Determine what constitutes adequate wage replacement levels at retirement (including benefits from public retirement funds and Social Security) for public employees.
(3) Study the impact of federal law and proposals concerning pensions, annuities, and retirement benefits.
(4) Study the retirement funds established in IC 36-8.
(5) Study methods and levels of funding for public retirement funds.
(6) Study other topics as assigned by the Legislative Council.
(7) Study other topics as directed by the Commission's chair.

The Commission consists of twelve members: four Representatives, four Senators, and four lay members who must be experts in the areas of finance, investments, or pension fund management. The chair of the Legislative Council appoints the chair of the Commission.

The Legislative Council assigned the following additional responsibilities to the Commission in 2007:

(1) The benefit structure of the Indiana State Teachers' Retirement Fund (TRF), assigned by SEA 29 (P.L.201-2007, SECTION 3) and the Legislative Council.
(2) The structure of TRF, assigned by HEA 1067 (P.L.149-2007, SECTION 6).
(3) Several issues related to the Judges' Retirement System assigned by HEA 1480 (P.L.68-2007, SECTION 3), including:
    (A) The implementation of a judges' defined contribution fund.
    (B) Any inequities that exist between the benefits provided by the 1977 Judges' Retirement System (1977 System) and the 1985 Judges' Retirement System (1985 System).
    (C) Identification of the ways in which the benefits provided by the 1977 System and the 1985 System may be aligned.
    (D) Consideration of possible employer contribution rates by the State to a judges' defined contribution fund, including a review of employer contribution rates for a judges' defined contribution fund that are consistent with employer contribution rates made by the State to other public pension plans.

II. INTRODUCTION AND REASONS FOR STUDY

The Commission determined that it would review the following issues:

A. Public Employees' Retirement Fund (PERF) Issues

The Commission heard testimony to determine whether to recommend: (1) a reduction in PERF's vesting requirement; (2) a reduction in the number of quarters used in PERF's final average salary computation; and (3) the withdrawal, under certain conditions, of a member's annuity savings account by a vested PERF member who separates from employment before being eligible to receive a retirement benefit.

B. TRF Issues

The Commission heard testimony to determine whether to recommend: (1) a definition of divorce, for purposes of allowing changes in TRF beneficiary designations, that includes all legally granted divorces, not just those granted in Indiana; (2) a reduction in the waiting period for reemployment in a TRF covered position after a TRF member's retirement; (3) the award of creditable service in TRF for all military service, regardless of when the service was performed; (4) a 2009 cost of living adjustment for TRF members, survivors, and beneficiaries; and (5) the computation of TRF's retirement benefit using a statewide average teacher's salary.

C. Judges' Retirement System Issues

The Commission heard testimony to determine whether to recommend: (1) the addition of full-time magistrates as members of the 1985 System; (2) the alignment of the retirement benefits provided under the 1985 System with the retirement benefits provided by the 1977 System; and (3) an increase in court fees to fund the proposed changes to the Judges' Retirement System.

D. Public Safety Pension Issues

The Commission heard testimony concerning the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund), including several issues raised by the 1977 Fund Advisory Committee and the transfer of 1977 Fund convertees to the 1977 Fund. The Commission also heard testimony to determine whether to recommend: (1) a correction to the computation of the supplemental benefit provided to members of the State Police Pre-1987 Benefit System; and (2) the transfer of State Police Motor Carrier Inspectors, the Capitol Police, and State Police Dispatchers from PERF to the State Excise Police, Gaming Agent, and Conservation Enforcement Officers' Retirement Fund.

E. Prosecuting Attorneys' Retirement Fund Issues

The Commission heard testimony to determine whether to recommend the alignment of the benefits provided by the Prosecuting Attorneys' Retirement Fund with the benefits currently provided by the Judges' Retirement System.

F. Other Issues Considered by the Commission

The Commission received reports concerning the following:

(1) PERF's annual report of operations, including a status report on the Legislators' Defined Contribution Plan Pilot Program.
(2) TRF's annual report of operations.
(3) A status report on the implementation of HEA 1067 (P.L.149-2007), which requires PERF and TRF, in the capacity of shareholders, to take certain actions involving companies with certain business activities in Sudan.
(4) A status report on the implementation of the retirement medical benefits account established by SEA 501 (P.L.44-2007).
(5) A status report on the implementation of a Section 401(h) account (a retirement medical expense reimbursement account for state employees established as a part of PERF).
(6) A report concerning the creation of an Institute for Pension Plan Management at Indiana University-Purdue University Fort Wayne (IPFW).

III. SUMMARY OF WORK PROGRAM

During the interim following the conclusion of the 2007 session of the General Assembly, the Commission met four times on the following dates to consider the topics described in II. (page 3 of this report):

August 29, 2007
September 12, 2007
October 17, 2007
October 31, 2007

All four meetings were held in the State House in Indianapolis.

IV. SUMMARY OF TESTIMONY

A. PERF Issues

(1) Vesting Requirement

The Commission heard a proposal from Phil Conklin representing the Retired Public Employees Association, Inc., to reduce from ten to eight years the vesting requirement for PERF. PERF's current ten year vesting requirement ranks near the bottom for public retirement plans in a national study conducted by the Wisconsin Legislative Council. The proposal would result in a .13% increase in the employer's annual contribution rate, and no change in PERF's funded status.

David Larson representing the Indiana State Employees Association (ISEA) testified in opposition to the proposal, because his members would prefer to see an increase in the multiplier used in the retirement benefit computation.

(2) Final Average Salary Computation

Mr. Conklin presented a second proposal to reduce from 20 to 12 the number of quarters used in PERF's final average salary computation. PERF's current use of 20 quarters in the final average salary computation ranks PERF at the bottom for public retirement plans in a national study conducted by the Wisconsin Legislative Council. The proposal would increase the employer's annual contribution rate by .65% and decrease PERF's funded status by approximately two percent.

(3) Withdrawal of a Member's Annuity Savings Account

Mr. Conklin presented a third proposal that would allow the withdrawal of the member's annuity savings account (ASA) by a vested PERF member who separates from employment for at least 90 days before being eligible to receive a retirement benefit. A PERF member who withdraws the member's ASA would not forfeit the ability to receive a pension benefit based on employer contributions when the member becomes eligible to do so. Allowing a member to withdraw the member's ASA before retirement would not have a fiscal impact on PERF.

Mr. Larson representing ISEA testified in support of the proposal.

B. TRF Issues

(1) Beneficiary Designations

The Commission heard a proposal from Ralph Ayres, Executive Director, Indiana Retired Teachers' Association (IRTA), to allow a TRF member who has begun receiving retirement benefits to change the member's beneficiary designation if the member and the member's designated beneficiary are parties in an action for dissolution of marriage. Under current law, a TRF member may change the member's designated beneficiary only if the member and the member's beneficiary are parties in an Indiana action for dissolution of marriage. A member would not be able to make the beneficiary change if a final order or property settlement: (1) prohibits a change to the member's designated beneficiary; or (2) provides a right to a survivor's benefit to a person who would be removed as a designated beneficiary.

(2) Waiting Period for Reemployment After Retirement

Mr. Ayres presented a second proposal to reduce from 90 days to 30 days the waiting period after which a retired TRF member could be reemployed in a covered position and continue to receive a retirement benefit. In response to concerns about whether the proposed reduction would jeopardize TRF's qualified status, the preliminary draft was revised to require that the reduction be implemented only if the TRF board of trustees receives from the Internal Revenue Service any rulings or determination letters that the board considers necessary or appropriate.

Gail Zeheralis and Nancy Pappas, representing the Indiana State Teachers Association (ISTA), and Sally Sloan, representing the Indiana Federation of Teachers (IFT) testified in support of the proposal.

(3) Military Service Credit

Mr. Ayres presented a third proposal to require TRF to award creditable service for all military service completed, regardless of when the TRF member performed the service.
The Commission's consideration of the proposal focused on limiting the service credit award to World War II and Korean War veterans, based on a bill from the 2007 session (HB 1036). That bill failed to advance because of the difficulty determining the true cost of the service credit.

In an attempt to obtain information in order to prepare a cost analysis, TRF surveyed 5,800 of its members who are males born before 1936 about their military service. The survey response was 52%. The responses indicated that 17% of the respondents had no military service, 23% had military service that had been credited by TRF under current law, 23% had military service that had not been credited by TRF under current law, and 37% had military service, but they were unsure whether the service had been credited by TRF under current law. The average length of service reported was three years.

Using the TRF survey results, John Dowell of Alliance Benefit Group, the TRF actuary, presented a report concerning the actuarial liability for the proposed award. Mr. Dowell determined that, for the surveyed group, the estimated increase in annual benefit payments attributable to the proposed award of service credit is $2,310,000 and the estimated increase in the present value of benefits is $22,100,000.

To provide some sort of estimate for the award of additional service credit for post-Korean War military service, Mr. Dowell extended the methodology and assumptions used in preparing his report to make a rough estimate. If the male post-Korean War military participation is 10%, the total annual cost for crediting both pre- and post-Korean War military service is $3.5 million, and the increase in the present value of benefits is $51 million. If the male post-Korean War military participation is 20%, the total annual cost for crediting pre- and post-Korean War military service is $4.5 million, and the increase in the present value of benefits is $78 million.

(4) Cost of Living Adjustment (COLA) for 2009

Mr. Ayres presented a fourth proposal to increase the pension portion of the monthly benefit in 2009 for TRF members, survivors, and beneficiaries. The proposed increase is 2% for members who retired or became disabled before July 2, 2000, and 1% for members who retired or became disabled after July 1, 2000, and before July 2, 2006. The estimated increase in the present value of future benefits attributable to the proposed COLA is $73.1M. One percent of the financial impact of the COLA, totaling $47.5M, is included in the actuarial evaluation. The net increase in the present value of future benefits associated with the proposed COLA, in addition to the assumed one percent, is $25.6M.

Nancy Pappas of ISTA and Nancy Tolson, incoming president of the IRTA, testified in favor of the proposal.

(5) Retirement Benefit Computation Using a Statewide Average Teacher's Salary

The Commission heard testimony from Representative Jeff Thompson concerning a proposal to use a statewide average salary amount to compute the pension portion of the retirement benefit for an individual who first becomes a member of TRF after June 30, 2008. Currently, the pension portion of the TRF retirement benefit is computed based on a member's average annual compensation for the highest five years of service before retirement. Representative Thompson explained that the goal of this proposal is the equalization of retirement benefits for all similarly situated teachers. The employer's contribution rate would be a flat amount, rather than an amount based on the compensation paid by the employer.

Frank Bush, Executive Director of the Indiana School Boards Association, John Ellis, Executive Director of the Indiana Association of Public School Superintendents, Nancy Pappas of ISTA, and Sally Sloan of IFT, all testified in opposition to the proposal.

C. Judges' Retirement System Issues

(1) Addition of Full-time Magistrates as Members of the 1985 System

The Commission heard testimony about a proposal from Indiana Judges Association to add full-time magistrates to the 1985 System. Magistrates currently are members of PERF. Jane Seigel, Executive Director, Indiana Judicial Center, and Judge Thomas J. Felts, President of the Indiana Judges Association, provided a history and overview of magistrates in Indiana. Magistrates Lou Rosenberg and Mick Jensen, both of Marion County, provided additional testimony and insights about magistrates and their duties.

Doug Todd, Senior Actuary, McCready and Keene, Inc., presented a fiscal analysis for the proposal. The analysis assumed that service credit in the Judges' Retirement System is granted for the magistrates' prior service in PERF, and that PERF and the magistrates contribute the

amount necessary to amortize the prior service liability.
The estimated fiscal impact of the proposal is an increase of $6,340,000 in the unfunded actuarial liability, an increase of $1,750,000 in annual funding by the State (employer), and a decrease from 65.3% to 62.4% in the funded status. In addition, the State would contribute approximately $883,000 each year for ten years to amortize the increase in the unfunded liability created by the magistrates' past service. The proposal would also decrease PERF's annual funding by $416,000.

The Commission requested modifications to the proposal that would: (1) delay the entry of magistrates into the 1985 System until January 1, 2011; and (2) require the magistrates to pay the total cost for the prior service credit transferred from PERF. The revised estimated fiscal impact of the proposal with these modifications is an increase of $3,473,552 in the unfunded accrued liability, an increase of $1,129,671 in annual funding, a decrease in annual funding (as a % of payroll) of 3.1%, a decrease of 0.2% in the funded status, and a decrease of $416,000 in PERF's annual funding.

(2) Alignment of Benefits under the 1985 System with Benefits under the 1977 System

The Commission heard testimony about a second proposal from the Indiana Judges Association that would align the retirement benefit of the 1985 System with the retirement benefit of the 1977 System. Currently, the retirement benefit for the 1985 System is computed using the annual salary paid to the participant at separation from service. The retirement benefit for the 1977 System is computed using the annual salary currently paid for the office which the participant held at the time the participant separated from service. As a result of this difference, the benefit paid by the 1977 System increases whenever the salary of the position that the participant held at separation from service increases, while benefit paid by the 1985 System increases only when the General Assembly enacts an ad hoc COLA.

Mr. Todd presented a fiscal analysis for the proposal. The analysis assumes that benefits payable by the 1985 System will increase under the same conditions and in the same amount as benefits are increased for the 1977 System. The analysis further assumes that the increase will be prospective and not include existing retirees. The estimated fiscal impact of the proposal is an increase of $34,220,000 in the unfunded actuarial liability, an increase of $5,040,000 in the annual funding by the State (employer), and a decrease from 65.3% to 56.4% in the funded status. He noted that the total salary for a circuit or superior court judge in Class 1-2 Counties increased approximately 140% from 1985 to 2007, or about 4% per year.

The Commission requested modifications to this proposal that would: (1) delay until January 2010, the alignment of the 1985 System benefit with the 1977 System benefit; and (2) apply the aligned benefit computation to all participants in the 1985 System, both active and retired participants. The revised fiscal impact of this proposal with the modifications is an increase of $47,297,068 in the unfunded accrued liability, an increase of $6,460,361 in the annual funding, an increase in the annual funding (as a % of payroll) of 19.0%, and a decrease of 9.6% in the funded status.

After reviewing the modified proposal, the Commission requested additional modifications to the proposal that would: (1) limit the benefit recomputation for retired participants of the 1985 System to prospective salary increases only (increases that occur after December 31, 2009); and (2) use in the benefit computation the participant's salary at termination for vested participants of the 1985 System who separate from service before January 1, 2010, but are not eligible to apply for a retirement benefit until after December 31, 2009. The fiscal impact of using the salary at termination in the benefit computation for vested participants who terminate service before January 1, 2010, is estimated to be an increase of $34,900,000 in the unfunded actuarial liability, an increase of $5,470,000 in the annual funding by the State, and a decrease from 65.3% to 57.9% in the funded status. The annual benefit payouts increase from $60,000 in FY 2009-2010 to $1,387,000 in FY 2015-2016.

(3) Increase in Court Fees to Fund the Proposed Changes

The Commission explored an increase in court fees in order to fund both proposals. Mark Goodpaster, Senior Fiscal Analyst, Indiana Legislative Services Agency, estimated that each one dollar increase in court fees will generate roughly $1M in additional revenue, so that a $1.50 increase in court fees would generate about $1,500,000, which would adequately fund both the addition of full-time magistrates to the Judges' Retirement System and the alignment of judges' benefits.

The Commission suggested an increase from $1.50 to $2.00 in the court fees as a part of the proposal. Mr. Goodpaster estimated that the revenue from a $2 increase in the court fees would total $2.18M upon full implementation. The increased revenue would exceed the Judges' Retirement System's increased benefit payout from FY2009 until FY2016. After that date, the benefit payouts are estimated to be greater than the revenues generated by the $2 fee increase.

Senator Mike Young proposed that the Marion County small claims courts be exempt from collecting the $2 increase in the court fees to pay for the changes in the Judges' Retirement System. Instead, he requested that the increased revenue collected by the small claims courts be used to fund the operations of the small claims courts.

D. Public Safety Pension Issues

(1) State Police Supplemental Benefit Computation

Steve Buschmann of Thrasher Buschmann Griffith & Voelkel, P.C., representing the Indiana State Police Alliance, presented a proposal concerned the computation of the supplemental benefit provided to members of the State Police Pre-1987 Benefit System. During the 2007 session, the method of computing the supplemental benefit was substantially reworked to allow retirees to receive the benefit earlier. However, the State Police Department determined that the language, as amended during the 2007 session, does not cover a trooper who: (1) retired with more than 20 years of service; and (2) cannot begin drawing a supplemental benefit immediately upon retirement, because the trooper has not reached 55 years of age. Mr. Buschmann asked that the computation of the supplemental benefit be revised to include, in the amount paid in the first year the retired member is eligible for the benefit, the salary increases paid to active members for the period after the member retired and before the member first qualifies for the supplemental benefit. The fiscal impact of this proposal was included in the fiscal note for the 2007 amendments.

(2) Transfer of State Police Motor Carrier Inspectors, the Capitol Police, and the State Police Dispatchers from PERF to the State Excise Police, Gaming Agent, and Conservation Enforcement Officers' Retirement Fund

Mr. Buschmann presented a second proposal to transfer the State Police Motor Carrier Inspectors, the Capitol Police, and State Police Dispatchers from PERF to the State Excise Police, Gaming Agent, and Conservation Enforcement Officers' Retirement Fund (C & E Fund). State Police Dispatchers were removed from the proposal because they are not dedicated law enforcement officers, and as a result, there is a question as to whether they could qualify for line-of-duty death and disability benefits.

Mr. Todd discussed the fiscal impacts to the C & E Fund of adding only State Police Motor Carrier Inspectors, only the Capitol Police, or adding both. If both groups are added to the C & E Fund, the annual funding will increase 1.6% and the funded status of the C & E Fund will decrease from 72.9% to 64.9%. The cost savings to PERF are estimated to be $320,000. Mr. Todd suggested that, because the C & E Fund has a mandatory retirement age of 60, the fiscal impact of the proposal could be lessened by limiting transfers to individuals who are younger than 60 years of age.

In response to a suggestion that the proposal be funded by adding a fee to the tickets issued by the officers who are participants in the C & E Fund, the Commission postponed further action on the proposal this interim to give interested parties time to gather information and prepare recommendations as to funding options for the proposal, including a proposed fee and how the fee might be imposed.

(3) Transfer of 1977 Fund Convertees to the 1977 Fund

Tom Hanify, President of the Professional Firefighters Union of Indiana, and Tom Miller of the Professional Firefighters Union, presented a proposal to transfer from the 1925 Police Pension Fund, the 1937 Firefighters' Pension Fund, and the 1953 Police Pension Fund (collectively, the Old Funds) to the 1977 Fund responsibility for benefit payments to certain members of the Old Funds who converted to the provisions of the 1977 Fund. The proposal is to transfer all remaining convertees into the 1977 Fund. The proposal would result in $196M in savings to the Old Funds and affect about 650 individuals, 200 to 300 of which are inactive members of the Old

Funds.

Mr. Todd presented the fiscal impact to the 1977 Fund if 1977 Fund convertees are transferred. He showed the impact in two situations: (1) only the remaining nonactive converted members of the Old Funds are transferred to the 1977 Fund; and (2) all remaining converted members of the Old Funds, both active and inactive, are transferred to the 1977 Fund. For the first option, the annual funding (as a percentage of a first class officer's salary) would increase from 21.0% (the contribution rate since the 1977 Fund was established) to 22.7%, and the funded status of the 1997 Fund would decrease from 97.2% to 89.9%. For the second option, the annual funding would increase from 21.0% to 25.5% and the funded status of the 1977 Fund would decrease from 97.2% to 83.3%. Cities and towns with Old Funds members would see decreases in the pension benefits paid.

Matt Brase of the Indiana Association of Cities and Towns said that the members of his association would need education to be able to weigh the pros and cons of supporting the proposal. Mr. Brase did not know what his membership wants to do.

Mr. Hanify said that, after the fiscal impact of the proposal is clearer, he may suggest a gradual transfer over as many as five years to avoid increasing the 1977 Fund's current contribution rate.

(4) 1977 Fund Advisory Committee Issues

Mr. Hanify asked the Commission to consider several issues raised by the 1977 Fund Advisory Committee, including the determination of disability pensions, hiring mental exams, the duties and operation of local pension boards, and a review of pre-1990 disability pensions granted under the 1977 Fund structure and the taxability of those pensions. PERF reported that it is addressing the issues raised by the 1977 Fund Advisory Committee.

<u>E. Prosecuting Attorneys' Retirement Fund</u>

Steve Johnson, Executive Director of the Indiana Prosecuting Attorneys Council, proposed the following legislative changes that would conform certain provisions of the Prosecuting Attorneys' Retirement Fund to current provisions of the Judges' Retirement System:

(1) Provide for a prorated retirement benefit for partial years of service.
(2) Eliminate required contributions for participants after 22 years of service.
(3) Increase the salary percentages so that a prosecutor's disability benefit is the same as a judge's disability benefit for the same years of service.
(4) Change the eligibility requirement for a disability benefit to a disability rendering the participant unable to perform the duties of a prosecutor.
(5) Eliminate the requirement that a participant complete at least five years of service in order to qualify for a disability benefit.

(6) Reduce from .25% per month to .10% per month the reduction factor for retirement before age 65.
(7) Increase the minimum death benefit paid from $7,000 to $12,000.
(8) For purposes of computing a retirement benefit, define "salary" to include the total salary paid to a participant by the state and by a county or counties.

Mr. Todd reviewed the estimated fiscal impact of the proposed legislative changes on the Prosecuting Attorneys' Retirement Fund. The total increase in the unfunded liability for all eight proposed changes combined is $1,470,000, the increase in annual funding is $413,000, and the increase in the annual funding as a percentage of payroll is 2.2%.

F. Reports to the Commission

(1) PERF's Annual Report

Terren Magid, Executive Director, presented PERF's 2007 annual report. PERF's statement of net assets of the Consolidated Retirement Investment Fund (CRIF), which contains substantially all of the investments for the plans administered by PERF, shows a 17% increase in total net assets between June 30, 2006, and June 30, 2007. CRIF's unaudited rate of return for FY2007 was 18.18%.

The actuarial funded status (ratio of assets to liabilities) and the amount of unfunded liabilities (in thousands of dollars) for the following plans are: PERF - 97.6% ($272,956.9); 1977 Fund - 97.2% ($67,067.0); Judges - 65.3% ($94,721.3); Excise, Gaming, and Conservation - 74.9% ($16,269.3); Prosecuting Attorneys - 68.7% ($9,130.4); and Legislators - 90.2% ($510.9). In the past year, the Judges' Retirement System made the greatest improvement in its funding status.

PERF's June 2007 Scorecard indicates, for PERF's statewide initiatives, $1,792,000 in annual savings and efficiency gains, $473,000 in one-time savings and efficiency gains, and $764,000 in competitive sourcing participation. PERF also met its customer service target: 100% of the retirees who followed PERF's retirement process began receiving a benefit within 30 days of retirement. PERF also increased member communications, especially for those members within five to ten years of retirement. In 2005, PERF developed a "bridge to retirement" program and has provided retirement workshops, counseling, online services, and written information to members nearing retirement.

In FY 2007, PERF improved its system of reporting service credit and completed its FY2006 Indiana State Board of Accounts audit earlier than in prior years. PERF received a clean audit opinion.

Mr. Magid gave a brief report on the status of the Legislators' Defined Contribution Plan Pilot Program. The Pilot Program was initiated on January 1, 2004, using a third party administrator, and currently has approximately 200 participants. The Pilot Program allows participants to change investment choices as frequently as they desire. It also offers many online services, such as viewing accounts, initiating transactions, and updating information. During the 2007 legislative session, the Pilot Program was extended until July 1, 2010. PERF has initiated a three to five year plan to resolve broader technology issues that include the operation of the Pilot Program, and currently is not prepared to recommend the extension of the Pilot Program to all PERF administered funds.

(2) TRF's Annual Report

Cristy Wheeler, Executive Director, presented TRF's 2007 annual report. During FY2006, TRF experienced increases in the number of retired members and inactive members, while the number of active members remained flat at 73,350. Members and beneficiaries totaled 151,414. Annuity and pension payouts increased from $607,180,997 to $650,032,403. Total accrued liabilities also increased from $16,264,893,444 to $17,365,572,132. Currently, assets under management total $7,791,423,832. Total investment return for FY2007 was 18.17%. In addition, TRF's asset management costs were 46.6 basis points, and its total adjusted administrative cost was $63 per member/retiree.

TRF received a clean audit from the Indiana State Board of Accounts. The fund averaged 16 days to process the first 85% benefit check and delivered 95% of the final adjusted payment amounts within 60 days after the first check. TRF's customer service accomplishments included offering Saturday counseling for fund members, maintaining 24-hour scanning/online access to new records, and maintaining an average wait time in the call center of less than 30 seconds.

In FY2007, the employer contribution rate for the 1996 Fund was 7% with a .5% cost of living adjustment (COLA) assumption. In FY2008, the contribution rate is 7.25% with a 1% COLA assumption. For FY2009, the contribution rate will be set early in 2008, but the COLA assumption will be 1.5%. TRF phased in the increased COLA assumption to avoid a big jump in the employer contribution rate.

The 1996 Fund increased its actuarially funded status from 63.1% to 93.5% as the result of investment gains and a $715,000,000 one-time transfer from the Pension Stabilization Fund to account for teachers who transferred membership from the Pre-1996 Fund to the 1996 Fund as the result of a change of employer. The unfunded liability of the Pre-1996 Fund increased from $8,457,422,000 to $9,525,249,000, and the actuarially funded status declined from 40.7% to 36.5%. The difference is attributable to the one-time transfer from the Pension Stabilization Fund to the 1996 Fund, the increasing COLA assumption, and investment gains. Ms. Wheeler discussed the Pension Stabilization Fund 50 year distribution projections for the pre-1996 Fund. In order to meet TRF's funding requirements, the General Assembly must appropriate 106% of its prior year appropriation every year until 2030.

(3) Sudan Divestment Status Report

Andrea Unzicker, PERF General Counsel, speaking on behalf of both PERF and TRF, provided a status report on the implementation of HEA 1067 (P.L.149-2007), which requires PERF and TRF, in the capacity of shareholders, to: (1) request that companies with certain business activities in Sudan cease those activities; and (2) sell or divest all publicly traded securities held in a company that is unresponsive to the request.

PERF and TRF are hiring Institutional Shareholder Services for assistance in identifying companies in the funds' portfolios that are engaging in prohibited business activities in Sudan. The list of companies engaging in the prohibited business activities is due at the end of October, and letter writing to the companies on the list should start shortly after that. Ms. Unzicker estimated that PERF has approximately five holdings valued at $14.4M in companies engaged in prohibited business activities in Sudan.

(4) Retirement Medical Benefits Account Plan (IC 5-10-8.5)

Christopher A. Ruhl, Director of the State Budget Agency, presented an update on the implementation of the retirement medical benefits account established by Senate Enrolled Act 501 (P.L.44-2007). Members of the General Assembly, state elected officers, and employees of the executive, legislative, and judicial branches may participate in the account, which has two components: active participants and retirees. Only a retired participant and covered dependents are entitled to receive benefits from the account, and the account may be used after retirement to pay premiums for individual and group health coverage provided by an insurance policy.

An annual contribution for active participants is paid by the participant's employer. The amount of the contribution is based on the participant's age. A bonus contribution is paid for a participant who:

(1) terminates service after June 30, 2007, and before July 1, 2017;
(2) has:
  (A) ten (10) years of service as an elected or appointed state officer; or
  (B) fifteen (15) years of service as an employee of the legislative, judicial, or executive branch of state government; and
(3) is eligible for and has applied to receive a normal, unreduced retirement benefit.

The amount of the bonus contribution is equal to the participants' years of state service multiplied by $1,000 and must be credited to the account within sixty (60) days after the participant's last day of service.

The state's estimated cost for the account in FY 2008 is approximately $50 million: $35 million for contributions for 31,300 active participants and $14 million for an estimated 750 retired participants. The account is funded by a combination of a general fund appropriation and amounts from certain dedicated funds. Cigarette tax revenues were intended to cover the general fund appropriation, while dedicated funds were expected to absorb the portion contributed by the state agencies for their employees. In fact, the cigarette tax revenues provide $23 million annually, leaving a funding shortfall of approximately $26 million per year.

The State Budget Agency has taken several actions to implement SEA 501. With the assistance of Krieg DeVault LLP, the Budget Agency has prepared a plan document and has selected Key Benefits Administrators as the third party administrator. A third step in the implementation of the account has been the creation of the necessary internal reports and communicating with state employees about the account.

The short term challenges of implementing the account include the following:

> (1) The fact that the account is a new benefit for state employees has resulted in the expenditure of more time and effort to implement and answer questions about the benefit than would be involved in expanding an existing benefit.
> (2) Lack of one central database for all eligible participants has increased the complexity of account administration.
> (3) M-Plan's withdrawal from the HMO market, because M-Plan's HMO was the only fully insured health insurance plan with statewide coverage offered by the State whose premiums could be reimbursed from the account.
> (4) Disputes over the years of service used to compute the bonus contribution have occurred, because some employees have both state and local service and only state service is used in the computation.

The identified long term challenges of implementing the account include the following:

> (1) The creation of a new system to manage the growing number of retired participants drawing benefits from the account.
> (2) The biggest question may be managing the cost shortfalls. The account is less than 50% structurally funded. The substantial annual deficit will recur until 2018 when the bonus contribution expires. The state is trying to manage its workforce more efficiently in order to realize cost savings to help fund the account, but more resources may be needed.
> (3) The potential of being required to report the account deficit as an OPEB liability on the state financial reports.

(5) Section 401(h) Account

Ms. Unzicker provided an update concerning PERF's implementation of a Section 401(h) account for state employees who are members of PERF. The account will provide a tax-free amount that may be used after retirement to pay medical-related expenses. When a state employee retires with unused vacation leave, the State is required to make a mandatory contribution equal to the number of unused hours of leave, up to a maximum of 30 days, times the employee's hourly pay rate at retirement. The state will also pay a 2 to 1 match for all converted amounts.

PERF submitted an approval request to the Internal Revenue Service in July and anticipates receiving an initial response by early 2008. If PERF receives Internal Revenue Service approval for the account, PERF anticipates implementation by Fall 2008. PERF is developing a request for proposals for an account administrator.

(6) IPFW Institute for Pension Plan Management

Dr. Geralyn Miller, Director of the new IPFW Institute for Pension Plan Management (Institute), discussed the creation of the Institute. The Institute has a three fold mission: (1) To provide education and training for industry professionals. (2) To provide a talent pipeline by means of the certificate program offered by the American Society of Pension Professionals and Actuaries. (3) To conduct research and provide technical support in the pension and retirement plan arena. The Fort Wayne-Allen County Economic Development Alliance, the Indiana Economic Development Corporation, and Lincoln Life Insurance are also involved in the Institute's start-up.

V. COMMITTEE FINDINGS AND RECOMMENDATIONS

The Commission made the following recommendations:

(1) The Commission unanimously recommended the introduction of Preliminary Draft 3063 which would add IC 5-10.2-5-43 to provide a cost of living adjustment in 2009 for certain members, survivors, and beneficiaries of TRF.

(2) The Commission unanimously recommended the introduction of Preliminary Draft 3064 which would amend IC 5-10.2-4-7.2 to allow a TRF member to change the member's beneficiary designation if the member and the member's designated beneficiary are parties in any action for dissolution of marriage.

(3) The Commission unanimously recommended the introduction of Preliminary Draft 3362 which would amend IC 5-10.2 and IC5-10.4 to reduce from 90 days to 30 days the waiting period after which a retired TRF member may be reemployed in a covered position and continue to receive a retirement benefit.

(4) The Commission unanimously recommended the introduction of Preliminary Draft 3065 which would amend IC 5-10.2-4-3 to reduce from 20 to 12 the number of calendar quarters used by PERF in the computation of the "average of the annual compensation".

(5) The Commission unanimously recommended the introduction of Preliminary Draft 3073 which would amend IC 5-10.2 and IC 5-10.3 to reduce from ten to eight the number of years of creditable service a PERF member must earn to obtain vested status.

(6) The Commission unanimously recommended the introduction of Preliminary Draft 3176 which would amend IC 5-10.2 to allow a PERF member who: (1) is vested; (2) separates from

covered employment for at least 90 days; and (3) is not eligible at separation to receive a retirement benefit; to elect to withdraw the member's annuity savings account. Unless the member has transferred the creditable service earned in PERF to another governmental retirement plan, a PERF member who elects to withdraw the entire amount in the member's annuity savings account is entitled to receive, when the member becomes eligible, a benefit equal to the pension provided by employer contributions.

(7) The Commission, by a vote of 8-1, recommended the introduction of Preliminary Draft 3414 with two amendments. The draft, as amended, would amend IC 33-23-5-13, IC 33-37, and IC 33-38 to: (1) allow a person serving as a full-time magistrate on July 1, 2010, and require a person who begins serving as a full-time magistrate after that date, to become a participant in the Judges' 1985 Benefit System; (2) allow under certain circumstances a judge who is a participant in the 1985 System to transfer to the 1985 System service credit earned as a full-time referee, commissioner, or magistrate after leaving a position covered by the 1985 System; (3) allow under certain circumstances a magistrate who is a participant in the 1985 System to purchase, at full actuarial cost, service credit for service earned in PERF as a full-time magistrate, referee, or commissioner; (4) after December 31, 2009, base the computation of the annual retirement benefit for a participant in the 1985 System on the salary being paid for the office that the participant held at the time of the participant's separation from service; (5) provide that certain participants in the 1985 System who retire before January 1, 2010, are entitled to receive an increased benefit based only on the percentage by which the salary being paid for the office that the participant held at the time of the participant's separation from service increases after December 31, 2009; and (6) increase the court administration fee from $3 to $5 and direct that the additional amount be paid into the Judges' Retirement Fund, except that the increased amount collected by the Marion County small claims courts is to be used to fund the operations of those courts.

(8) The Commission unanimously recommended the introduction of Preliminary Draft 3278 which would amend IC 10-12-5 to revise the computation of the supplemental benefit provided to members of the State Police Pre-1987 Benefit System.

(9) The Commission unanimously adopted its final report with the understanding that the report will be modified to include actions taken during the Commission's October 31, meeting.

W I T N E S S L I S T

August 29, 2007

Terren Magid, Executive Director, Public Employees' Retirement Fund
Cristy Wheeler, Executive Director, Indiana State Teachers' Retirement Fund
Judge Thomas J. Felts, President of the Indiana Judges Association
Doug Todd, Senior Actuary, McCready and Keene, Inc.
Mark Goodpaster, Senior Fiscal Analyst, Indiana Legislative Services Agency
Jane Seigel, Executive Director, Indiana Judicial Center
Tom Hanify, President of the Professional Firefighters Union of Indiana
Steve Buschmann, Indiana State Police Alliance
Ralph Ayres, Executive Director, Indiana Retired Teachers' Association

September 12, 2007

Doug Todd, Senior Actuary, McCready and Keene, Inc.
Mark Goodpaster, Senior Fiscal Analyst, Indiana Legislative Services Agency
Judge Thomas J. Felts, President of the Indiana Judges Association
Magistrate Lou Rosenberg, Marion County, Indiana
Magistrate Mick Jensen, Marion County, Indiana
Ralph Ayres, Executive Director, Indiana Retired Teachers' Association
Gail Zeheralis, Indiana State Teachers Association
Sally Sloan, Indiana Federation of Teachers
Julia A. Pogue, Chief Financial Officer, Indiana State Teachers' Retirement Fund
Cristy Wheeler, Executive Director, Indiana State Teachers' Retirement Fund
Andrea Unzicker, General Counsel, Public Employees' Retirement Fund
Phil Conklin, Retired Indiana Public Employees Association, Inc.
Representative Jeff Thompson
Frank Bush, Executive Director, Indiana School Boards Association
John Ellis, Executive Director, Indiana Association of Public School Superintendents
Nancy Pappas, Indiana State Teachers Association
Tom Hanify, President of the Professional Firefighters Union of Indiana
Tom Miller, Professional Firefighters Union
Matt Brase, Indiana Association of Cities and Towns
Steve Buschmann, Indiana State Police Alliance

October 17, 2007

Cristy Wheeler, Executive Director, Indiana State Teachers' Retirement Fund
Christopher A. Ruhl, Director, State Budget Agency
Andrea Unzicker, General Counsel, Public Employees' Retirement Fund
Dr. Geralyn Miller, Director, IPFW Institute for Pension Plan Management
Ralph Ayres, Executive Director, Indiana Retired Teachers' Association

Tom Davidson, General Counsel, Indiana State Teachers' Retirement Fund
John Dowell, Actuary, Alliance Benefit Group
Steve Johnson, Executive Director, Indiana Prosecuting Attorneys Council
George Awkerbrand, Gibson County Prosecutor's Office
Amy Levander Flack, Indiana Judges Association
Doug Todd, Senior Actuary, McCready and Keene, Inc.
Mark Goodpaster, Senior Fiscal Analyst, Indiana Legislative Services Agency
Elaine Beatty, McCready and Keene, Inc.
Steve Buschmann, Indiana State Police Alliance

October 31, 2007

Doug Todd, Senior Actuary, McCready and Keene, Inc.
Mark Goodpaster, Senior Fiscal Analyst, Indiana Legislative Services Agency
Judge Thomas J. Felts, President of the Indiana Judges Association
Ralph Ayres, Executive Director, Indiana Retired Teachers' Association
Nancy Pappas, Indiana State Teachers Association
Nancy Tolson, President, Indiana Retired Teachers' Association
Phil Conklin, Retired Indiana Public Employees Association, Inc.
David Larson, Indiana State Employees Association
Tom Davidson, General Counsel, Indiana State Teachers' Retirement Fund
Steve Buschmann, Indiana State Police Alliance